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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1938

No. 13 Original

STATE OF CALIFORNIA,

Complainant,

vs.

MURRAY W. LATIMER, JAMES A. DAILEY and LEE M. EDDY, individually and as members of the Railroad Retirement Board, and GUY T. HELVERING, individually and as Commissioner of Internal Revenue,

Defendants.

Supplemental Brief of Complainant State of California on Defendants' Motion to Dismiss Bill of Complaint

THE STATE OF CALIFORNIA
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STATEMENT REGARDING THE PLEADINGS

These proceedings were initiated by complainant by lodging its bill of complaint in this court together with a motion for leave to file the same. Subsequently and on April 11, 1938, a rule was issued requiring defendants to show cause why

leave to file the bill of complaint should not be granted. Defendants in their response opposed the motion for leave to file and filed therewith a brief in support of such opposition. In reply complainant filed its brief in support of motion for leave to file bill of complaint. On May 16, 1938, leave to file the bill was granted and process was made returnable on October 3, 1938. On the latter date defendants filed a motion to dismiss bill of complaint, supported by points and authorities, together with their answer to the bill of complaint.

At the outset, defendants in their memorandum suggest that the suit be dismissed as to defendant Dailey in view of the fact that his term of office expired on August 29, 1938, and that no successor has yet been appointed. In this connection we request that the court take no action upon this suggestion at this time, but that when a successor to defendant Dailey is appointed the court permit complainant to substitute such successor in defendant Dailey's place and stead.

We call the court's attention to the Act of Congress of February 13, 1925 (C. 229, 43 Stat. 936, 941, U. S. C. Tit. 28, Section 780; 28 U. S. C. A. 780) reading in part as follows:

> "* * * Where, during the pendency of an action, suit, or other proceeding brought by or against an officer of the United States, * * * and relating to the present or future discharge of his official duties, such officer dies, resigns, or otherwise ceases to hold such office, it shall be

competent for the court wherein the action, suit, or proceeding is pending, whether the court be one of first instance or an appellate tribunal, to permit the cause to be continued and maintained by or against the successor in office of such officer, * * *"

FOREWORD

On page 4 of their memorandum of points and authorities defendants contend that the issues raised by their response to the rule to show cause were not adjudged against them by the decision of the court to allow complainant to file its bill of complaint, and that the same issues may again be presented to the court by the present motion to dismiss.

Defendants rely upon cases which set forth the procedure formerly followed by this court in original actions in which the complainant was a sovereign state. Under that procedure the state was granted leave to file, as of course, and without prejudice to the defendant's raising any jurisdictional objections through the medium of a motion to dismiss. See

Louisiana vs. *Texas,* 176 U. S. 1;
Washington vs. *Northern Securities Co.,* 185 U. S. 254;
Kansas vs. *United States,* 204 U. S. 331, 337.

In the last named case there was an objection by the defendant, the United States, on the ground

of lack of jurisdiction. In granting leave to file, the court said:

> "As such an application by a state is usually granted as of course, we thought it wiser to allow the bill to be filed but reserved to the United States the right to object to the jurisdiction thereafter, and the words 'without prejudice' were inserted in the order."

While defendants also rely upon *Georgia* vs. *Morgenthau,* No. 16 Original, 296 U. S. 544, we call to the court's attention the fact that the complainant, the State of Georgia, subsequent to the filing of its complaint and prior to an argument on defendant's motion to dismiss, voluntarily dismissed its bill of complaint (297 U. S. 726).

It would appear that since the case of *Florida* vs. *Mellon,* 273 U. S. 12, a new practice has been developed whereby this court orders a rule to issue on the question of granting leave to file, requiring defendant to appear and show cause why leave to file the bill of complaint should not be granted. Under this procedure, which was followed in the instant case, the defendant appears on the return day of the rule, both parties then file briefs on the question, and the court takes the matter under advisement, disposing of such jurisdictional questions as there may be and either granting or denying leave to file.

Having followed this procedure and having granted leave to file the bill in the case now before the court, it would appear that the court has already

disposed of such jurisdictional objections as were called to the court's attention by the defendants in response to the rule to show cause.

Nevertheless, since defendants have renewed in their motion to dismiss their objections to the complaint on jurisdictional grounds, and have adopted by reference the brief which they have heretofore submitted in this cause in support of their response to the rule to show cause, and have further discussed additional matters not covered in that brief, we think that it is only proper that the complainant should at this time refer the court to complainant's brief which was submitted in support of its motion for leave to file, in which we met the jurisdictional issues presented by defendants at that time. In addition to this brief we now respectfully submit to the court the following argument in response to the additional matters discussed by defendants in their memorandum in support of motion to dismiss the bill of complaint.

ARGUMENT

I

Defendants' Citizenship Affords a Basis for the Jurisdiction of this Court

Under Point I of the additional argument made by defendants in support of their motion to dismiss, it is argued that the citizenship of defendants affords no basis for the jurisdiction of this court.

It is argued that defendants "can and will act only as officials"; that if one of the defendants should resign and his office be filled by a citizen of California, "the essential nature of the controversy would remain unaltered and the real parties in interest would remain the same"; citing *Minnesota* vs. *Hitchcock,* 185 U. S. 373, 383-384; and that it was held in *Texas* vs. *Interstate Commerce Commission,* 258 U. S. 158, 160, that "governmental agencies are not citizens of any state but bear the same relation to one state as to another without regard to the citizenship of their personnel."

In answer we point out that the defendants Latimer, Dailey and Eddy are sued "individually and as members of the Railroad Retirement Board," and that Guy T. Helvering is sued "individually and as Commissioner of Internal Revenue."

It is to be noted that the suit is not brought against the Railroad Retirement Board as a board, neither is suit brought against any of the officials in his official capacity. This is a suit against the individuals named, and it is alleged in the complaint that such individuals are purporting to act in their respective official capacities.

In *Texas* vs. *Interstate Commerce Commission, supra,* the court at page 160 said:

> "But both defendants are sued as corporate entities created by the United States for governmental purpose; and, if that be their status, they are not citizens of any state, but have the same relation to one state as to another."

We do not question this principle but point out that in the case at bar the complainant has not sued any corporate entity, board or agency of the United States.

In *Minnesota* vs. *Hitchcock, supra,* the State of Minnesota, pursuant to a congressional act, named the then Secretary of the Interior as a proper party defendant and claimed that this court had original jurisdiction because that officer was a citizen of Missouri. In answer to this contention the court at pages 383-384 said:

> "To that it may be replied that there is no real controversy between the state, the plaintiff, and the defendants as individuals; that the latter, merely as citizens, have no interest in the controversy for or against the plaintiff; that in case either of the defendants should die or resign and a citizen of Minnesota be appointed in his place, the jurisdiction of the court would cease and this, although the real parties in interest remain the same."

In the case now before the court the real controversy arises because the defendants as citizens of their respective states, purporting to act as officials, have illegally attempted to apply the federal acts involved in the action to the complainant herein. The acts of which the State of California complains are the unauthorized acts of these citizens of other states, acting under color of official authority, but wholly outside of the proper scope of such authority.

The defendants herein, in acting outside of the scope of their authority, can be interested in the controversy only as citizens, for the obvious reason that as officers of the United States they have no interest in the acts done by them without official authorization.

If a resident of California were appointed in place of defendant Dailey, whose term of office has expired, the situation would be different from that which existed in *Minnesota* vs. *Hitchcock, supra,* because in that case the real controversy was between the state and the United States, the latter being the real party in interest. Here, however, while the nature of the controversy would remain the same if a resident of California took the place of defendant Dailey, the real parties in interest would change, because the United States is not the real party in interest when its officials act outside of their authority. On pages 42 and 43 of complainant's brief in support of motion for leave to file bill of complaint it is shown that the United States is not the real party in interest where an officer acts in excess and abuse of his power. To the cases there cited may be added *Allen* vs. *Regents of University System,* 304 U. S. 439, 55 S. Ct. Rep. 980, 982. In that case the court, citing cases, said:

> "We are not unmindful of the principle that suits against officers to restrain action in excess of their authority or in violation of statutory or constitutional provisions *are in their nature personal.*"

II

This Suit Is Not Prohibited by Section 3224, Revised Statutes

At pages 34-39, inclusive, of complainant's brief in support of motion to file bill of complaint it is shown that section 3224, Revised Statutes, does not forbid maintenance of this suit. That conclusion is in no manner affected by the decision in *Allen* vs. *Regents,* 304 U. S. 439.

We submit that the court in *Allen* vs. *Regents* recognizes the long accepted doctrine that there are two exceptions to the provision of section 3224, Revised Statutes. The first exception is that section 3224, Revised Statutes, does not apply in the case where the complainant shows that in addition to the illegality of an exaction in the guise of a *tax* there exist special and extraordinary circumstances.

The second exception is that section 3224, Revised Statutes, does not apply where there is an attempt to impose a penalty as distinguished from a tax.

We note in reading the *Allen* case that the court held that the lower federal court rightly entertained proceedings therein either on the theory that there was an action to collect a tax or on the theory that the action was one to enjoin the collection of a penalty for failure to collect a tax.

III

The State of California, Complainant Herein, In the Construction, Maintenance, Operation, Management and Control of the State Belt Railroad, Is Immune From the Excise Tax Sought to Be Levied Pursuant to the Carriers' Taxing Act of 1937

In Point III of their additional points and authorities defendants seek to establish that the issues presented by complainant have been decided against it by previous decisions of this court. They refer to pp. 46-50 of their brief in response to the rule to show cause, where they claim to have shown that previous decisions of this court have disposed of all questions presented by the complaint. They then cite the recent cases of *Helvering* vs. *Gerhardt,* 304 U. S. 405, 58 S. Ct. Rep. 969, which they claim shows the narrow room for any claim of immunity against federal taxation, and *Allen* vs. *Regents,* 304 U. S. 439, 58 S. Ct. Rep. 980, which defendants refer to as clarifying the principle that a business enterprise, even though conducted by a state, can not share the sovereign immunity against taxation.

A. Analysis of *Helvering* vs. *Gerhardt.*

In the case of *Helvering* vs. *Gerhardt, supra,* the question for decision was whether the imposition of a federal income tax for the calendar years 1932 and 1933 on salaries received by Gerhardt and others as employees of the Port of New York Authority placed an unconstitutional burden on the states of New York and New Jersey.

In the decision of the court many of the cases bearing upon the immunity of state instrumentalities from federal taxation were reviewed and considered. The legislation establishing the Port Authority was reviewed and the main purposes and powers of the Authority set forth. This court laid down the principle that any constitutional restriction upon the taxing power granted to Congress, so far as it can be properly raised by implication, should be narrowly limited, and stated:

> "In tacit recognition of the limitation which the very nature of our federal system imposes on state immunity from taxation in order to avoid an everexpanding encroachment upon the federal taxing power, this Court has refused to enlarge the immunity substantially beyond those limits marked out in *Collector* vs. *Day* (11 Wall. 113, 20 L. Ed. 122). It has been sustained where, as in *Collector* vs. *Day,* the function involved was one thought to be essential to the maintenance of a state government."

The rule thus announced as to immunity of the functions of a state government from federal taxation is stated somewhat differently from the rule applying to the same subject, as stated in *Helvering* vs. *Powers,* 293 U. S. 214, where the court said:

> "The principle of immunity has inherent limitations. And one of these limitations is that the state cannot withdraw sources of revenue from the federal taxing power by engaging in businesses which constitute a *departure from usual governmental functions,* and to which, by rea-

son of their nature, the federal taxing power would normally extend."

We do not think, however, that this new statement of the rule limits the state functions which have hitherto been considered as immune from federal taxation.

The court further said that the judicial pronouncements marking the boundary of state immunity definitely establish two guiding principles of limitation for holding the tax immunity of state instrumentalities to its proper function. The first of these principles, dependent upon *the nature of the function* being performed by the state or in its behalf, excludes from the immunity activities thought *not to be essential to the preservation of state governments* even though the tax be collected from the state treasury. As illustrations of activities carried on by a state which this court decided not to be essential for the preservation of state government, the court cited the carrying on of a liquor business by the state, as illustrated in *South Carolina* vs. *United States,* 199 U. S. 437, 26 S. Ct. Rep. 110, 50 L. Ed. 261, and in *Ohio* vs. *Helvering,* 292 U. S. 360, 54 S. Ct. Rep. 725, 78 L. Ed. 1307; and the operation of a privately owned street railroad as illustrated in *Helvering* vs. *Powers,* 293 U. S. 214, 55 S. Ct. Rep. 171, 79 L. Ed. 91.

The second principle was referred to in the decision as exemplified by those cases where the tax laid upon *individuals* affects the state only as the

burden is passed on to it by the taxpayer and the burden on the state is so speculative and uncertain that, if allowed, it would restrict the federal taxing power without affording any corresponding tangible protection to the state government.

Metcalf & Eddy vs. *Mitchell,* 269 U. S. 514; 46 S. Ct. Rep. 172, 70 L. Ed. 384;
Willcuts vs. *Bunn,* 282 U. S. 216, 51 S. Ct. Rep. 175, 75 L. Ed. 304.

In applying these principles to the case before the court the statement was made that the challenged income taxes were upon net incomes of respondents

> "derived from their employment in common occupations not shown to be different in their methods or duties from those of similar employees in private industry."

We point out that *Helvering* vs. *Gerhardt* does not involve a tax upon a state or a political subdivision of a state or upon a state instrumentality. In this connection the court said:

> "*Expressing no opinion whether a federal tax may be imposed upon the Port Authority itself* with respect to its receipt of income or its other activities, we decide only that the present tax neither precludes nor threatens unreasonably to obstruct any function essential to the continued existence of the state government."

The decision therefore is not authority for the proposition that the Carriers' Taxing Act of 1937

applies to the State of California as owner of the State Belt Railroad.

Indeed, it is strongly intimated by the court that there may be cases where the employees of a state engaged in carrying on the function of a state government may be taxed, when the state itself or the particular function exercised may be immune from a tax. Witness the words of the court, as follows:

> "* * * even though the function be thought important enough to demand immunity from a tax upon the state itself, it is not necessarily protected from a tax which well may be substantially or entirely absorbed by private persons."

The difficulty in determining whether a state in exercising a particular function is subject to federal taxation does not arise from the statement of the general rule governing such immunity but from the application of the rule to the particular function sought to be taxed.

B. Analysis of *Allen* vs. *Regents etc.*, 304 U. S. 439, 58 S. Ct. Rep. 980.

In their supplemental brief, defendants refer to *Allen* vs. *Regents, supra,* as "further clarifying the principle that a business enterprise, even though conducted by a state, can not share the sovereign immunity against taxation."

Applying the principle upon which *South Carolina* vs. *United States, supra,* was decided, to the facts of *Allen* vs. *Regents,* this court said:

"The important fact is that the State, in order to raise funds for public purposes, has embarked in a business having the incidents of similar enterprises usually prosecuted for private gain. If it be conceded that the education of its prospective citizens is an essential governmental function of Georgia, as necessary to the preservation of the State as is the maintenance of its executive, legislative, and judicial branches, it does not follow that if the State elects to provide the funds for any of these purposes by conducting a business, the application of the avails in aid of necessary governmental functions withdraws the business from the field of federal taxation.

"Under the test laid down in *Helvering* vs. *Gerhardt*, 304 U. S. 405, 58 S. Ct. 969, 82 L. Ed. —, decided this day, however essential a system of public education to the existence of the State, the conduct of exhibitions for admissions paid by the public is not such a function of state government as to be free from the burden of a nondiscriminatory tax laid on all admissions to public exhibitions for which an admission fee is charged."

We concur that this statement is indeed a clarification, if any were needed, of the rule of the case of *South Carolina* vs. *United States, supra.* Still we must say as we have said with respect to *Helvering* vs. *Gerhardt, supra,* that there is no difficulty in understanding the general rule; the problem to be solved is the proper application of the rule.

There was no question in the case of *Allen* vs. *Regents* that the athletic exhibitions which were burdened by the tax were not essentially different in character from athletic contests carried on by private promotors. The facts of the case showed that the contests were conducted for profit, and that the stadia of the University of Georgia and the Georgia School of Technology were, to a great extent, paid for by the income derived from the admissions upon which the tax was levied. The profits were used to finance an admittedly governmental function, to-wit, the education of prospective citizens of Georgia.

The business of conducting athletic contests, considered taxable in this case, is in striking contrast to the operation of the State Belt Railroad and the Harbor of San Francisco, of which the railroad is an indispensable part, in that:

(1) The harbor and the railroad are not conducted for profit, since the rates charged by these instrumentalities for services are limited by law to amounts sufficient to pay expenses. (Harbors and Navigation Code of California, Section 3084.)

(2) The operation of harbors and terminal railroads connected therewith is historically and traditionally a governmental function. (Pp. 15-18, brief in support of motion for leave to file bill of complaint.)

(3) There is no private business conducted in a comparable manner.

On pages 14 and 15 of our brief in support of motion for leave to file bill of complaint we considered the cases of *South Carolina* vs. *United States, supra, Ohio* vs. *Helvering, supra,* and *Helvering* vs. *Powers, supra,* and showed that there is a clear distinction between the state functions involved in those cases, and the administration of the Harbor of San Francisco, including the operation of the State Belt Railroad, which is the function involved in the case at bar.

On pages 8 and 9 of that brief, by a reference to the Harbors and Navigation Code of the State of California, made a part of the complaint, we showed the nature of the instrumentality of the state which operates San Francisco Harbor and the State Belt Railroad. We also referred on page 9 to the decisions of this court, the Supreme Court of the State of California, and the Board of Tax Appeals holding that the Board of State Harbor Commissioners, in administering the harbor and the railroad, is engaged in performing governmental functions. On pages 10 and 11 of the brief we gave a partial enumeration of the powers of a governmental nature exercised by said board and showed that the State Belt Railroad is not a separate entity from the Board of State Harbor Commissioners, but is simply one of the instrumentalities used by it in administering the San Francisco Harbor.

In the above discussion we submit we have shown clearly that there is a wide difference between the

functions exercised by the Board of State Harbor Commissioners, including the operation of the State Belt Railroad, and the conducting of a liquor business, which was involved in *South Carolina* vs. *United States, supra,* and *Ohio* vs. *Helvering, supra,* and the administration of the railroad, which was the subject of the action in *Helvering* vs. *Powers.*

On page 15 of our brief hereinabove mentioned we made the point that governments have universally exercised the function of developing and operating their ports and harbors. In this connection we referred to the case of *Commissioner* vs. *Ten Eyck,* 76 Fed. (2d) 515, and we again respectfully call the court's attention to the learned discussion by the court in that case and its holding that port and harbor developments have historically been regarded as governmental functions, and that the operation of a railroad by a port commission as one of its instrumentalities does not impress such railroad with the character of a private enterprise, but on the contrary that in operating such a railroad the state is engaged in "a usual governmental function as distinguished from a proprietary function."

IV

Unconstitutionality, in General, of Both 1937 Acts

For the purposes of this case we have so far argued that the Railroad Retirement Acts of 1935 and 1937 and the Carriers' Taxing Act of 1937 are unconstitutional if held to apply to the State of

California in its operation of the State Belt Railroad.

It may not be amiss for us to say that in our opinion these two acts are unconstitutional in all events.

The 1934 Act, the forerunner of the later acts, was held by this court to be unconstitutional in *Railroad Retirement Board* vs. *Alton Railroad,* 295 U. S. 330 (1935).

In that act (Act of June 27, 1934, Ch. 868, 48 Stat. 1283) the retirement features were combined with the taxing features.

This court found the act to be unconstitutional on the following grounds:

> "(a) That the provisions of the act which disregard the private and separate ownership of the several respondents treat them all as a single employer and pool their assets regardless of their individual obligation, cannot be justified as consistent with due process;
>
> "(b) Because the act is unreasonably and unconscionably burdensome and oppressive upon the respondents;
>
> "(c) Because several of the inseparable provisions of the act contravene the due process of the law clause of the fifth amendment;
>
> "(d) That even if the act could survive the loss of unconstitutional features already discussed it is bad for a reason which goes to the heart of the law, namely that the act is not in purpose or effect a regulation of interstate commerce within the meaning of the Constitution."

In 1935 Congress enacted a statute establishing a retirement system for employees of carriers (49 Stat. 967, 45 U. S. C. A. Section 215 et seq.). In this act there were no provisions for a tax. However, the same Congress enacted a statute providing for the levy of an excise tax upon carrier employers and an income tax upon carrier employees (49 Stat. 974, 45 U. S. C. A. Section 241 et seq.).

In the case of *Alton Railroad Company* vs. *Railroad Retirement Board,* 16 Fed. Supp. 955, these two acts came before the District Court of the United States for the District of Columbia, and in a decision handed down on June 26, 1936, that court held that the two acts were inseparable parts of a whole; that Congress would not have enacted one without the other, and that the taxing act transcended the powers of Congress and was unconstitutional as applied to the carriers.

Our information is that this case was on its way to an appellate court when Congress enacted the two acts here in question, namely, the Railroad Retirement Act of 1937 and the Carriers' Taxing Act of 1937.

So far as we are advised, the constitutionality of these two acts has not been raised in any court proceeding. If so, apparently the case has not yet reached this court.

Even if it be conceded that objections (b) and (c) to the 1934 act, as stated above, have been overcome in the 1937 acts, we believe that objections (a) and

(d) are as applicable to the 1937 acts as they were to the 1934 act.

The 1937 acts disregard the private and separate ownership of the carriers and treat them as a single employer, their contributions being pooled regardless of their individual obligations. In the *Alton* case this court said that such provisions could not be justified as consistent with the due process clause of the constitution.

Objection (d) above, which this court in the *Alton* case said went to the heart of the law, has not been removed.

Congress has again attempted, through the medium of two acts instead of one, to carry out purposes which can not be effected through a regulation of interstate commerce within the meaning of the constitution.

To put the matter in a different form, Congress has again attempted to accomplish social security objectives for railway employees under the guise of regulating interstate commerce. This court held in the *Alton* case that the constitution does not justify such effort.

In conclusion, we submit that our Bill of Complaint presents an equitable issue cognizable by this court and in no true sense controverted by the pleadings or briefs of the defendants.

We respectfully pray, therefore, that the court overrule the motion to dismiss and determine this cause upon its merits.

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